



Fiscal Year 2002

# DEPARTMENT OF THE NAVY

## Annual Financial Report

# Department of the Navy Annual Financial Report Fiscal Year 2002

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# Message from the Secretary of the Navy



**THE SECRETARY OF THE NAVY**  
WASHINGTON, D.C. 20350-1000



January 2003

Today's Navy-Marine Corps Team remains the predominant maritime force in the world today. During this past year, our Sailors and Marines have advanced the long War on Terror. As we move forward, the Department of the Navy will continue to focus on fighting and winning the Nation's wars while we transform for the future.

The Fiscal Year (FY) 2002 DON Financial Statement also represents the continuation of the Department's business transformation. These efforts, described in Naval Vision 21 as "Sea Enterprise," will lead our Department to become an enterprise that is both effective and more efficient.

We will pursue this transformation by improving our business practices and driving resources from the bureaucracy to our operating forces. The department's top business priority will be to identify and increase resources available to grow and sustain the core combat capabilities that focus on our Naval Forces' warfighting readiness and combat credibility.

This FY 2002 Annual Report provides a means for Congress and the public to review and measure the effectiveness of the Department of the Navy's financial responsibility. As we fight and win the first war of the 21st century, this report shows the Department's commitment to our fiscal accountability. We want the citizens of this great Nation to be proud of the stewardship of their Navy.



Gordon R. England



# Message from the Assistant Secretary of the Navy (Financial Management & Comptroller)



**THE ASSISTANT SECRETARY OF THE NAVY**  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
1000 NAVY PENTAGON  
WASHINGTON, D.C. 20350-1000



January 2003

I am pleased to submit the Department of the Navy's (DON) Fiscal Year (FY) 2002 Annual Financial Report. This report reflects the DON's stewardship and financial accountability of resources that has become even more important as the Department moves into the 21st century.

Presently, there are a myriad of systems and processes that initiate, record, summarize, control, and report financial transactions and events. The Department of Defense (DoD) and the DON are committed to becoming more efficient, working on ways to improve "how we do business" corporately rather than concentrating only on specific programs and systems.

At the forefront of this effort is the DoD Financial Management Enterprise Architecture (FMEA) Initiative. The FMEA will not only provide a framework for conducting financial operations throughout the DoD, but will also address the standardization of data elements and transactions that are key to linking functional business processes and systems with financial management processes and systems.

During FY 2002 the Department continued ongoing efforts to support the FMEA fully. Initiatives such as Enterprise Resource Planning, converting the accounting systems to the United States Standard General Ledger, and implementing the Navy Marine Corps Intranet will place the DON in an advantageous position to transition to the architecture developed by the FMEA team.

All of these initiatives, as part of a DoD-wide solution, embody a transformation process that will ensure the DON is both effective and efficient as the Department is engaged in a Global War on Terrorism while maintaining the highest level of fiscal accountability.

A handwritten signature in black ink, appearing to read "Dionel M. Aviles".

Dionel M. Aviles



# DEPARTMENT OF THE NAVY MANAGEMENT'S DISCUSSION AND ANALYSIS



# Management's Discussion and Analysis

## DEPARTMENT OF THE NAVY MANAGEMENT'S DISCUSSION AND ANALYSIS

### Introduction

The Department of the Navy (DON) operates the most potent naval forces in the world today, and constantly strives to reinforce its supremacy. The Navy and Marine Corps provide highly skilled, operationally agile, combat-ready forces that enhance stability, deter conflict, and triumph over all threats in all environments.

The 21st century promises to be a challenging time for the DON. The international environment is constantly evolving, and it is imperative as the department strives to sustain its current and future readiness that it continue to attract, train, and retain highly skilled and motivated people. Success in this goal demands that Sailors and Marines be given a high-quality work environment and that their families be afforded a decent standard of living. Operationally, the DON must realize a force that is fully transformed to meet the challenges ahead, that is aligned to all threats, and that is capable of triumphing in all situations. The department's preparations must be comprehensive and innovative to extract the maximum advantage from its resources and to achieve the highest possible rate of return on its investments. The DON's organization, systems, and processes must be structured to deliver a combat-capable naval force ready to stand in harm's way anytime and anywhere.

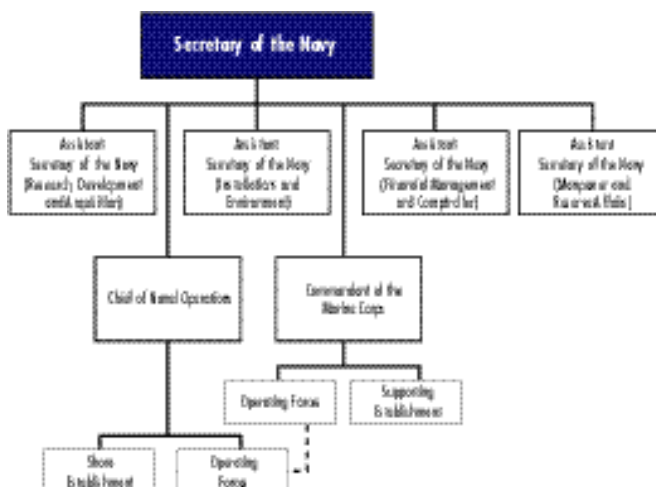


### The Department of the Navy

The U.S. Navy was founded on 13 October 1775 and the U.S. Marine Corps on 10 November 1775. On 30 April 1798 DON was formally established. The broad organizational structure of the DON today is shown in the figure below (for more detail see <http://www.chinfo.navy.mil/navpalib/organization/org-over.html>).

For the purposes of financial reporting, the DON is organized into two reporting entities: the Navy Working Capital Fund (NWCF) and the General Fund (GF). Each fund supports the department's overall mission, but where the GF receives direct appropriations from Congress, the NWCF relies principally on reimbursements from the GF and from other sources.

General Fund operations are supported by multiple appropriations: Operations and Maintenance (O&M); Military Personnel; Procurement; Research, Development, Test, and Evaluation; and Military Construction and Family Housing. The NWCF operates under the revolving fund concept, wherein the fund's activities are reimbursed by their customers for the full cost of goods and services provided. This contractual customer-provider relationship serves the interests of both the GF and the NWCF: it provides the NWCF with the means to continue operations and also provides a way of effectively controlling costs; for the GF, it provides an effective and flexible means of financing, budgeting, and accounting for costs.





### THE DON MISSION

The Department of Defense has developed a strategic framework for the defense of the nation. This framework is built around four defense policy goals:

- **Assure** allies and friends
- **Dissuade** future military competition
- **Deter** threats and coercion against U.S. interests
- **Defeat** any adversary if deterrence fails

The DON's purpose throughout history has been to serve the economic and political well being of the United States and to help secure the American way of life. The world's oceans can be barriers for defense, avenues for commerce, or a base from which to project military power. The DON ensures America's ability to use the oceans, in peace and in war, and is prepared to deny their use to our adversaries.

*"The Navy shall be organized, trained, and equipped primarily for prompt and sustained combat incident to operations at sea. It is responsible for the preparation of naval forces necessary for the effective prosecution of war except as otherwise assigned and, in accordance with integrated joint mobilization plans, for the expansion of the peacetime components of the Navy to meet the needs of war."*

(Section 5062, Title 10, U.S. Code)

*"The Marine Corps shall be organized, trained, and equipped to provide fleet marine forces of combined arms, together with supporting air components, for service with the fleet in the seizure or defense of advanced naval bases and for the conduct of such land operations as may be essential to the prosecution of a naval campaign."*

(Section 5063, Title 10, U.S. Code)

The Constitution of the United States empowers Congress to "provide and maintain a Navy." In accordance with Title 10 of the U.S. Code, Congress requires the Navy to be organized, trained, and equipped to support both the singular and complementary missions of the Navy and Marine Corps in the manner that, through achieving maritime superiority, most effectively serves U.S. national security strategy.

The Secretary of the Navy has identified four interrelated strategic areas that are critical to the mission of the DON: combat capability, people, advanced technology, and business practices.

### Combat capability

The U.S. National Military Strategy requires that the nation's armed forces be prepared to and be capable of shaping the international environment and of responding to any and all crises. The DON's battle force ships, aviation units, and Marine forces provide the foundation tools for the fulfillment of this strategy. World-wide, the operational activities of the Navy and Marine Corps include drug interdiction work, joint maneuvers, multinational training exercises, humanitarian assistance, and, when called upon, contingency operations such as those currently being undertaken in the Arabian Gulf, the Balkans, and in Afghanistan as part of Operation Enduring Freedom. On any given day, nearly 47,000 DON Sailors and Marines, on nearly 95 ships, are deployed around the world.



# Management's Discussion and Analysis

## People

A fully trained and highly motivated force is the most important element in the DON's readiness equation; consequently, personnel development and retention are among the department's most pressing challenges. To ensure the long-term effectiveness of its forces, the DON is committed to a strategy that focuses on recruiting the right people, retaining the right people, and reducing attrition.

Military manpower overall is declining, due in large part to the force restructuring that is being undertaken to meet the changing demands of warfighting. During FY 2002, however, the increased requirement that the war on terror has introduced for skill-specific staffing in areas such as antiterrorism and force protection resulted in a rise in Navy personnel levels. The DON comprises more than half a million men and women, as shown below.

**Department of the Navy Active Personnel**

	FY 2001	FY 2002
Navy - Officers	53,908	54,500
Navy - Enlisted	319,580	324,696
Midshipmen	4,217	4,281
Marine Corps - Officers	18,062	18,288
Marine Corps - Enlisted	154,872	155,445
<b>Total End Strength</b>	<b>550,639</b>	<b>557,210</b>

Sources: FY 2002 estimated figures were derived from the FY 2004 Highlights of the Department of the Navy Budget Submission to the Secretary of Defense, August 2002. FY 2001 actual figures were derived from the FY 2003 Highlights of the Department of the Navy Budget Submission to the Secretary of Defense, February 2002.

*"Caring for the safety and the professional and personal well-being of our people is inherent in Navy values-it is indispensable to mission accomplishment. We must retain our quality people."*

— The Navy Policy Book

Supplementing active personnel in FY 2002 were approximately 87,958 Navy Reservists and 39,905 Marine Reservists. DON reservists are highly trained units capable of augmenting and reinforcing the active forces. Effective integration of the reserve elements with the active component is critical to the continuing ability of the DON to fulfill its mission.

The DON also integrates civilian personnel at all levels of the organization. Civilian end strength in FY 2002 was approximately 195,328. Predominantly assigned ashore, especially in repair, design, and acquisition, the department's civilian personnel provide the expertise and assure the continuity of support that are essential to our operating forces.

## Advanced technology

The effective application of advanced technology is at the core of America's military dominance. The DON operates the most technologically advanced naval force in the world, but to preserve this advantage it is essential that the department sustain its robust science and technology programs. The DON's development efforts currently are focused on connectivity, on providing a common tactical picture, refining sensor-to-shoot capabilities, and on sustaining command and control warfare. This technology is essential to the DON's commitment to realizing the capability to deliver high-volume, precision strikes in all weather and in all terrain, and to the development of interoperational systems that enable seamless joint operations.

## Business practices

The DON has been a leader in the innovative adoption and adaptation of modern business practices, and continues to pioneer in this area with a vision for the fullest possible integration of advanced technology with proven best practices. By increasing the efficiency with which it conducts its business, the department will both increase its buying power and free up resources that then can be redirected into combat capability.







## Summary of FY 2002 Operations

In FY 2002 as in years past, the DON operated extensively in representation of U.S. interests. Forward-deployed forces continued to reassure our allies and to deter our potential enemies. In East Timor, the department also assisted the humanitarian efforts of the United Nations Transition Assistance.

*"Since Operation Enduring Freedom began, our men and women in uniform have performed magnificently in the struggle against world terrorism. Your valour, on the battlefield and off, at sea and in the air, and at military installations across the world, inspire all those who cherish freedom."*

— Secretary of the Navy  
The Honorable Gordon England

In the Mediterranean, Navy ships operated with friends and allies in more than 85 exercises. Marines of the Sixth Fleet Marine Expeditionary Units (MEUs) fulfilled a dual role by providing a presence ashore in Kosovo and by serving as the Joint Task Force Commander's ready reserve. In South America, Marines participated in riverine and small unit training.

In Southwest Asia, U.S. naval forces maintained a continuous carrier presence throughout the year, conducting combat operations in support of Operation Southern Watch over Iraq. For the tenth consecutive year, surface combatants performed maritime interdiction operations in support of UN economic sanctions against Iraq. Marines from the 15th and 22nd MEUs trained and exercised with friends and allies throughout Southwest Asia.

In the war against terrorism, naval forces were the first to respond, first to fight, and first to secure U.S. interests. Demonstrating the decisiveness, responsiveness, agility, and sustainability that are key to naval services, it was carrier-based Navy and Marine aircraft that undertook most of the early combat sorties of Operation Enduring Freedom, and it was Tomahawk cruise missiles from DON ships and submarines that attacked communications and air defense sites. In the days that followed, the DON worked seamlessly with the other services to sustain carrier strikes on sites that were further inland than had ever before been attacked from the sea. Submarines in the region provided tactical and persistent intelligence, surveillance, and reconnaissance, and maritime patrol aircraft provided reconnaissance and surveillance capabilities in support of Special Operations Forces and Marine units on the ground.

On the ground, it was Marines that provided the first conventional ground force presence in Afghanistan, establishing a secure foothold in a hostile environment and assuring access for follow-on forces. Navy Seabees improved runways, enhanced conditions at forward operating bases far inland, and established detainee camps.

## CHARTING A NEW COURSE

*"The major institutions of American national security were designed in a different era to meet different requirements. All of them must be transformed."*

— The National Security Strategy of the United States of America

# Management's Discussion and Analysis

*On September 7, 2002, Secretary of the Navy Gordon England announced the naming of a planned amphibious transport dock ship, LPD-21, New York to honor the state, the city, and the victims of September 11.*



Terrorism and other emerging threats demand that the Navy and Marine Corps transform themselves for the challenges of the 21st century. The DON vision of transformation fundamentally requires the balancing of capabilities. This is true whether the subject of transformation is ships, airplanes, weapons systems, or financial management technologies.

The National Security Strategy of the United States reflects the union of American values and national interests. The aim of this strategy is to help make the world not just safer, but better. The goals of the strategy are clear: political and economic freedom, peaceful relations with other states, and respect for human dignity. To achieve these goals, the United States will:

- champion aspirations for human dignity and foster respect for human life world-wide
- strengthen alliances to defeat global terrorism and work to prevent attacks against America and its friends
- work with others to defuse regional conflicts
- prevent anyone from threatening America, its allies, and its friends with weapons of mass destruction
- ignite a new era of global economic growth through free markets and free trade
- expand the circle of development by opening societies and building the infrastructure of democracy
- develop agendas for cooperative action with other main centers of global power
- transform America's national security institutions to meet the challenges and opportunities of the 21st century

## Naval Transformation Roadmap

The DON's transformation roadmap describes the concepts, capabilities, and processes that are central to achieving transformation. It explains how naval forces will contribute to the joint warfighting capability of the future and what changes are being implemented to promote a culture of innovation. Innovation in particular will be required to support the six critical operational goals of the U.S. military as defined in the 2001 Quadrennial Defense Review (QDR).

The 21st century will see unprecedented advances in the precision and operational reach of military operations, in connectivity, and in information dissemination. These advances will produce and enable the exploitation of a dispersed battlespace within which sovereign and sustainable naval, air, ground, and space elements will form a unified force capable of simultaneously projecting offensive power and maintaining defensive capability. They also will enable the DON to be fully integrated into the larger joint force, where through the application of state-of-the-art sensors, networks, decision aids, weapons, and supporting systems it will operate a single, comprehensive maritime network.





## Operational Goals of the 2001 QDR

- Protect critical bases of operations and defeat chemical, biological, radiological, and nuclear explosive weapons and their delivery
- Assure integrity of information systems in the face of attack and conduct effective information operations
- Project and sustain U.S. forces in distant anti-access or area denial environments and defeat anti-access and area-denial threats
- Deny enemies sanctuary by providing persistent surveillance, tracking, and rapid engagement with high-volume precision strikes, through a combination of complementary air and ground capabilities, against critical mobile and fixed targets at various ranges and in all weather and over any terrain
- Enhance the capability and survivability of space systems and supporting infrastructure
- Leverage information technology and innovative concepts to develop an interoperable, joint C4ISR (command, control, communication, computer, intelligence, surveillance, and reconnaissance) architecture and capability that includes the ability to produce a tailorable joint operational picture

## Naval Power 21

The overarching mission of the DON is to defend the United States, through actions undertaken overseas and at home. Given this mission, Naval Power 21 defines the future direction for the U.S. Navy and Marine Corps: control the seas, assure seaborne access to anywhere in the world, project power beyond the sea, and influence events and advance American interests using the full spectrum of military operations. There are three core components to Naval Power 21:

- Assuring access. Assure seaborne access world-wide for military operations, diplomatic interaction, and humanitarian relief efforts.
- Fighting and winning. Project power to influence events at sea and ashore, both at home and overseas.

- Continually transforming and improving. Transform concepts, organizations, doctrine, technology, networks, sensors, platforms, weapon systems, training, education, and the approach to people.

## The DON vision depends on four fundamental qualities:

- Decisiveness
- Sustainability
- Responsiveness
- Agility

## The DON will focus on seven areas:

- **People.** The capabilities of the DON depend first and foremost on its people. The DON's people are its most important resource.
- **Homeland Security.** The DON will address threats to America's security and engage potential adversaries.
- **Projecting Power and Influence: Winning at Sea and Beyond.** The DON's capabilities enable its forces to move directly from ship to operational objectives far inland.
- **Future Naval Capabilities: Transformational by Design.** Innovative business processes and technologies support and enable the realization of the DON's strategic vision, revolutionary operational concepts, and agile, adaptive organization.
- **Sea Enterprise: Capturing Business Efficiencies.** The DON will optimize resources at every level of the chain of command to become an enterprise that is both effective and efficient.
- **The Future: An Expanded Naval Force.** The DON's objective is the balanced joint force mix that will provide the best warfighting capability for the United States.
- **Organizing the Force: A Naval Operational Concept.** By developing and continually revising the Naval Operational Concept, the DON will identify the capability packages vital to meeting the nation's needs for a constantly transforming force.

# Management's Discussion and Analysis

The strategies of the Navy and Marine Corps are individually defined in Seapower 21 and Marine Corps Strategy 21. These documents describe the future of the DON as part of a joint force and describe capstone concepts that will focus efforts and resources within the DON on the same goal.

## Seapower 21

Seapower 21 provides the strategic framework that will guide the Navy into the 21st century. It emphasizes the needs for integrated experimentation and innovation, continual personnel development, and the adoption of private sector best practices to increase the efficiency with which the Navy conducts its business. It will enable the Navy's full integration with the other services into a platform from which future joint warfighting campaigns will be waged across sea, air, land, space, and cyberspace. Seapower 21 takes as a priority assuring the future readiness of the Navy, and in particular the readiness and capability to fulfill the Commander-in-Chief's direction to "take the fight to the enemy" in the war on terrorism.

Seapower 21 comprises three core operational concepts: Sea Strike, Sea Shield, and Sea Basing.

- **Sea Strike.** Sea Strike is a concept for the projection of dominant and decisive offensive power in the support of joint objectives. The concept highlights the four key areas of strategic agility, operational maneuverability, precise weapons employment, and the indefinite sustainment of naval forces. It also provides a strategy for the development of the multidimensional capabilities for power projection that the Navy will need in order to operate with new combinations of forces and from new platforms, such as the Expeditionary Strike Force.

The DON will maintain the capability to project offensive power by traditional means, including missiles, guns, and special operations troops. As new systems such as unmanned aircraft and miniaturized munitions are perfected and as information technology advances, Sea Strike will

integrate these with existing systems to amplify the effects of sea-based striking and further increase the Navy's ability to achieve offensive operational success.

- **Sea Shield.** Sea Shield is a concept for the enhancement of the Navy's ability to defend the United States, the joint force, and America's coalition partners. The concept requires that the Navy use its control of the seas and its forward-deployed defensive capabilities and network intelligence to defeat an enemy's area-denial strategy, thus enabling and sustaining the joint force in its projection of power. Sea Shield will extend homeland defense to the fullest extent possible: perhaps the most dramatic advancement it prescribes is the ability of naval forces to project precise, defensive firepower, including ballistic and cruise missiles, deep inland. The defensive umbrella thus envisioned will both assure friends and allies and protect the joint force. Sea Shield, when fully realized, is projected







through deterrence to have a stabilizing effect in the event of future crises but also will be a powerful tool on future battlefields. Sea Shield transformational capabilities currently being pursued include Theater Air and Missile Defense (TAMD), Littoral Sea Control, and Homeland Defense.

- **Sea Basing.** The concept of Sea Basing addresses the need to assure that the sovereign naval platforms of the joint force have operational independence. The concept envisions the use of advanced high-speed vessels, long-range naval fire support systems, and connectivity to provide sustainable global projection and protection of American power from the high seas at the operational level of war. It will leverage emerging technologies and operational concepts to provide unprecedented support for the joint force, with the objective of enabling the best possible staging for joint command and control over vast maneuver areas. Changes that will take place ashore, where increased agility and mobility will result in fluid operation throughout the battle space and superior situational awareness, are equally important. In the event of conflict, Sea Basing will enable tailored, agile forces to rapidly execute unpredictable campaign plans. On completion of their mission these forces will be swiftly extracted to their sea base, where they will be resupplied and reconstituted for further operations.

At the core of Seapower 21 is FORCEnet, the program through which the DON is pursuing the reality of network-centric warfare. The goal of FORCEnet is the creation, through the development of sensors that enable the full integration of command and control platforms, of a distributive combat system that reaches all DON personnel.

### **Marine Corps Strategy 21**

Marine Corps Strategy 21 describes the vision, goals, and aims of the Corps as it seeks to enhance its strategic agility, operational reach, and tactical flexibility in support of joint, allied, and coalition operations. These capabilities are essential to the ability of the Marine Corps to provide scalable,

interoperable, combined Marine air-ground task forces able to shape the international environment, to respond quickly across the complex spectrum of crises and conflicts, and to assure access or prosecute forcible entry where and when required. The underlying concepts of the strategy include:

- the development of Marines able to win America's battles who exemplify American ideals in peacetime as well
- optimization of the operating forces and the support and sustainment base, and pursuit and optimization of the Marine Corps' unique capabilities
- sustainment of the enduring Navy—Marine Corps relationship
- reinforcement of the Marine Corps' strategic partnership with the Army, Air Force, and U.S. Special Operations Command
- contribution to the development of joint, allied, coalition, and interagency capabilities
- capitalization on innovation, experimentation, and technology

To advance these concepts, the Marine Corps has introduced the capstone concept of Expeditionary Maneuver Warfare, which brings together the Marine Corps' core competencies, maneuver warfare philosophy, expeditionary heritage, and sea basing with the integrating, operational, and functional concepts by which the Marine Corps will organize, deploy, and employ forces today and in the future.

### **The President's Management Agenda**

The President's Management Agenda (PMA) is a strategy for improving the management and performance of the federal government. Reflecting the Administration's commitment to achieving immediate, concrete, and measurable improvements in federal management, the PMA provides five government-wide initiatives to serve as a starting point for reform.

The next section focuses on the tenets outlined in the PMA, and addresses what the DON is doing to answer the President's call for reform.

# Management's Discussion and Analysis

## The Five PMA Initiatives

- Improved financial performance
- Budget and performance integration
- Strategic management of human capital
- Competitive sourcing
- Expanded electronic government

### Improved financial performance

It is critical that DON managers be furnished with accurate, comprehensive, and useful financial management information. It is only with this information that they are able to make the investment decisions and develop the operational strategies that most effectively use scarce budget resources. In accordance with the Department of Defense (DoD) initiative of developing the DoD-wide Financial Management Enterprise Architecture, the DON therefore has adopted a comprehensive strategy of migratory systems enhancement and business process standardization. Modernization of the DON financial systems and initiatives such as Enterprise Resource Planning pilots, U.S. Government Standard General Ledger implementation, and the Navy/Marine Corps Intranet are making progress and will significantly improve both the quality of information and the efficiency of DON business processes.

## Financial Management Enterprise Architecture

Early in 2001, the Secretary of Defense commissioned an independent study of DoD financial management under the auspices of the Institute for Defense Analysis. "Transforming the Department of Defense Financial Management: A Strategy for Change," was published in April 2001. The study found that no single source was addressing the key issues end to end, neither at a strategic nor at a programmatic level. In short, DoD lacked an overarching approach to financial management. In response to the study, the Secretary of Defense established the Defense Financial Management Modernization Program Office (DFMMPO), and tasked it with developing a blueprint for a DoD-wide financial management architecture. FMEA, the Financial Management Enterprise Architecture, will be consistent with the DoD Chief Information Officers' Information Technology Architecture.

## The Vision

DoD will be managed in an efficient, businesslike manner in which accurate, reliable, and timely financial information, affirmed by clean audit opinions, is available on a routine basis to support informed decision-making at all levels throughout the department.



torpedo boats to multimission-capable combatants tasked with an ever expanding range of operations. DON destroyers played an active role in every major armed conflict of the past century. The heritage of destroyers responding to the call of duty continues today as our destroyers support Operation Enduring Freedom.

2002 marks the centennial year of the destroyer, one of the DON's great ship classes. Destroyers have transformed from single-mission platforms tasked with destroying





The DON fully supports the DFMMPO's efforts, and with other stakeholders is participating in all aspects of development of the enterprise architecture. In October 2002 the DFMMPO released a draft "strawman" architecture that covers the following overarching business process areas from a systems, technical, and operational view:

- accounting
- logistics
- property, plant, and equipment
- collection and accounts receivable
- operations
- financial management reporting
- procurement, payable, acquisition, and disbursing
- human resource management
- programming, budget, and funds control

The purpose of the strawman architecture is to outline the principles behind the development of the architecture, to identify any necessary changes in high-level business practice, and to address known deficiencies within each of the business process areas.

The Department of Defense also is taking steps to formulate a transition plan, with the understanding that overhauling the department's business operations and financial management is a major challenge that extends far beyond the initial step of developing an enterprise architecture. Successful implementation of the architecture will require a robust plan that addresses and guides change not only in technology but also in business operations, information standards, management practices, and cultural norms. Because of the variety and complexity of the DoD business operations environment, the transition plan will provide guiding design principles rather than narrow definitions of how systems and processes should operate - in essence, it will serve as a high-level, comprehensive master plan that permits local customization as each department moves from the "as is" to the "to be" environment. As the transition effort progresses from design to implementation, the DON anticipates that its involvement in the effort and its coordination with DoD will grow.

## Enterprise Resource Planning

Enterprise Resource Planning (ERP) is a business management system that through integrating the different business processes of an enterprise, consolidating business systems, and consolidating data entry seeks to increase the efficiency of the enterprise. A DON Commercial Business Practices working group identified ERP as appropriate for the DON for its ability to:

- provide decision-quality information to all levels of management
- improve efficiency and effectiveness through the reengineering of business processes and the delivery to managers of integrated information
- manage costs, thus enabling the reallocation of resources to recapitalization and modernization
- enable compliance with statutory requirements such as the Government Performance and Results Act (GPRA) and the Chief Financial Officers (CFO) Act

The implementation of ERP solutions is helping move the DON toward CFO Act compliance by enabling the department to (1) meet federal financial management regulations, accounting standards, and requirements; (2) implement the U.S. Government Standard General Ledger (USSGL); and (3) provide 100 percent drill-down capability to source transaction events.

The DON has initiated four pilot programs to determine the effectiveness of ERP solutions across a broad range of business practices. Two of these pilots, CABRILLO and NEMAIS, were operational in FY 2002, with notable success.

The CABRILLO pilot project, which is designed to improve business operations, processes, and support systems, was the first to be inaugurated.

In July 2001, employees at the Space and Naval Warfare Systems Center in San Diego began using the new system for tracking property, ordering supplies, establishing contracts, and preparing project reports and financial statements. The CABRILLO ERP solution replaces numerous legacy systems and simplifies management by integrating multiple mandated information systems and databases. It also has the benefit of providing users with a single entry point to all financial applications, information, and services.



# Management's Discussion and Analysis

NEMAIS, or Navy Enterprise Maintenance Information System, is a pilot project designed to standardize ship maintenance functions ashore. NEMAIS affords ships visibility of shoreside data and enables connectivity to contractor systems for new construction, thereby permitting the use of common processes for the entire ship maintenance community. The project comprises four pilot phases: Ship Intermediate Maintenance Activities, Naval Shipyards, Supervisors of Shipbuilding (SUPSHIPS), and Afloat Platforms. The Ship Intermediate Maintenance Activities pilot went live in Norfolk in June 2002, and as of September was operating in 52 ships. The Naval Shipyard pilot is scheduled to go live in October 2003, with the SUPSHIPS and Afloat Platforms slated to go live in early 2004.

Two further Navy pilot programs were preparing to go live during FY 2002. Project Sigma, the Navy's Program Management Pilot, was scheduled for launch on October 1, 2002 at NAVAIR Headquarters. A follow-up implementation is scheduled for January 2003 at the Naval Air Warfare Center Aircraft and Weapons Division. Project Sigma is an enterprise solution that will replace many legacy systems and that will provide NAVAIR and the Navy with a single point of data entry and real-time, accurate financial information.

The fourth pilot program is the System Maintenance Aviation Reengineering Team (SMART) pilot, a joint venture between NAVSUP and NAVAIR. Scheduled to go live on December 1, 2002, the SMART pilot is designed to streamline aviation maintenance and supply.

The DON and Under Secretary of Defense (Comptroller) (USD(C)) leadership will evaluate each pilot on completion before moving forward with full-scale implementation. In particular, the DON is working closely with the USD(C) DFMMPO team to ensure that the ERP strategy fully supports the FMEA direction and transition plans. The DON also has established a Navy Enterprise Convergence Team (NECT) to standardize configuration and processes across the pilot programs, and ultimately to develop an ERP solution that eventually can be rolled out to other DON activities.

## Financial standardization and reinvention

The DON also is pursuing several other initiatives aimed at improving financial performance. These include the following:

- **Accounting standardization.** The DON Uniform General Ledger, based on the U.S. Government Standard General Ledger, consists of the uniform Chart of Accounts (COA) and Standard Transaction Library (STL). Together the COA and STL list the resources available and applied to meet the mission goals and program objectives of the DON. The COA is the common source of information that will enable the coordination of efforts to develop a standard enterprise-wide information architecture. Where the COA provides the standard framework for expressing business events in financial terms, the STL defines the content and application of accounts within the COA. Within the existing, or migratory, systems, the DON STL will provide the tool needed to clarify the transaction posting logic, ensuring that common business events are translated accurately into financial transactions for all DON activities and commands.
- **Report streamlining.** In partnership with the Defense Finance and Accounting Service (DFAS), the DON is examining a number of reporting problems and developing strategies to resolve them. The approach being taken is to change the emphasis from report design to the identification and definition of key management information. The Marine Corps, for example, is implementing a process to identify unnecessary, duplicative, or excessive reporting requirements. Reports to be eliminated will be identified through the Business Industry Council (BIC), a group of private sector professionals that is coordinating with DoD to leverage private sector best practices.
- **Accounts Payable Implementation Strategy.** The DON has initiated the development of an Accounts Payable Implementation Strategy to improve the recording and reporting of accounts payable. The strategy addresses the overall DON approach to recording accounts payable, including accounts payable from commercial





and intragovernmental sources. Development of the implementation strategy is in its final stages and includes several recommendations for improvements. These address, for example, the timely recording of accounts payable transactions, the proper classification of accounts payable between the government and the public, the identification of intragovernmental trading partners and related transactions, and the support of end-of-period adjusting entries for undistributed disbursements and intragovernmental eliminations.

## BUDGET AND PERFORMANCE INTEGRATION

The full and effective integration of budget and performance data will require the use of performance metrics in managing and justifying program resources.

Performance-based budgeting seeks to shift the focus of attention from detailed items of expense to the allocation of resources based on program goals and measured results. As budgets decline and budgetary decision-making becomes more difficult, performance-based budgeting will become increasingly important, by providing a tool that enables the problem of duplicative programs to be addressed, by supporting creation of a framework that integrates and compares decisions that affect related programs, and by offering an alternative to across-the-board reductions.

*"In the long term, there are few items more urgent than ensuring that the federal government is well run and results-oriented."*

— President George W. Bush

Improving programs by focusing on results is an integral component of the DON's budget and performance integration initiative. The Office of Management and Budget (OMB) accordingly has instituted Program Performance Assessments for the budget process that provide a rating system that is consistent, objective, credible, and transparent. As OMB solidifies its management requirements the

DON will update its performance scorecard for each of the areas outlined in the President's Management Agenda.

## STRATEGIC MANAGEMENT OF HUMAN CAPITAL

The DON has experienced rapid downsizing of almost 45 percent since 1989. Much of this downsizing was accomplished through across-the-board reductions and hiring freezes, rather than through targeted reductions. As a result, the DON faces an employment challenge that is common to the federal government: the need to reshape the workforce to ensure that the right people, with the right skills, are in the right jobs, and that the department thus is optimally equipped to meet the challenges of the future.

Given the speed of technological change, it is essential that the DON recruit the best people possible. The department is building on the successes of Navy and Marine Corps commands in identifying and expanding the use of best recruitment practices to attract high-quality individuals at entry and mid-career levels; specifically, better than anticipated manning in FY 2002 helped reduce at-sea billet gaps and allowed the DON to begin to fill new positions that have been created in areas such as antiterrorism and force protection. The DON is also examining and using innovative workforce-shaping strategies to ensure that its civilian workforce is able to meet its responsibilities as an integral part of the total force.

In addition, "the DON has undertaken a number of initiatives to make its processes more sailor centered." These include a Sailor Advocacy Program that has expanded outreach to Sailors by their personnel managers. Improved compensation and better skill development programs also are being instituted as a means of shaping careers and thus of helping the department meet its current and future staffing requirements.

Professional development and training programs are central to good personnel management. The Navy has launched Task Force EXCEL (Excellence through Commitment to Education and Learning) to create a "Revolution in Training," leveraging distance learning technologies

# Management's Discussion and Analysis

and an improved information exchange network to support a career-long training continuum. The Navy College Program and the Marine Corps Lifelong Learning Program both support the career-long professional development of DON personnel; examples of programs that rely heavily on advanced distance learning systems include the Marine Corps' Satellite Education Network (MCSEN) and the MarineNet Distance Learning Program.

Professional growth of the DON's financial management workforce is supported by the Civilian Financial Management Career Program Improvement (CFMCPI). The CFMCPI endorses a variety of training methodologies, including mentoring and organizational rotation assignments. The DON additionally aids its financial managers in their pursuit of the Certified Government Financial Manager (CGFM) and Certified Defense Financial Manager (CDFM) designations. The CGFM and CDFM programs address a wide range of knowledge and skills, and are invaluable in helping the department's financial managers stay abreast of emerging practices and technologies.

## COMPETITIVE SOURCING

The DON's FY 2004 budget submission fully reflects the PMA initiative to use commercial business practices to improve operational effectiveness and efficiency and to realize savings for modernization and recapitalization. The department's Strategic Sourcing program has identified more than 100,000 civilian and military positions that will be reviewed for potential conversion to outsourcing.

The cost comparisons completed to date have found that 80 percent of the positions reviewed have remained in-house. Approximately 56,000 positions remain under review. Current projections, however, indicate that the outsourcing of those functions that thus far have been found appropriate for commercial sourcing are on target to realize budgeted annual net savings of \$1.6 billion, beginning in FY 2005. These savings attest to the DON's commitment to institutionalize the Strategic Sourcing process to realize cost reductions and to reshape its infrastructure to suit the requirements of the 21st century.

*"The reinvention of government begins by focusing on core mission competencies and service requirements. Thus, the reinvention process must consider a wide range of options, including:*

- the consolidation, restructuring, or reengineering of activities;*
- the adoption of better business management practices; and*
- the termination of obsolete services or programs."*

— OMB Circular A-76

Revised Supplemental Handbook, 27 March 1996

## EXPANDED ELECTRONIC GOVERNMENT

The DON has implemented the eBusiness (eB) initiative to shift its business transactions to follow commercial standards and practices. The initiative centers on the interchange and processing of information via electronic techniques, but prior to the uptake of those techniques DON business process first must be reengineered and streamlined. The eB Operations Office is the DON's innovation center for eB concepts. Its charter specifies two main objectives:

- serve as a catalyst for the creation, realization, and integration of eB concepts via Pilot Projects, and provide consulting and research services department-wide
- centralize control of existing card-based electronic transaction systems





The Marine Corps' "Managing for Results" initiative will link resources consumed by DoD installation activities to performance outcomes, customer demands, and work outputs by using Activity-Based Costing and Management tools. The Marine Corps will then identify and share best practices across the services."

The 22 pilot projects funded in FY 2002 have had far-reaching benefits. These include the provision of on-demand access to combat system performance and readiness information; the automation of aviation depot maintenance condition data; the paperless distribution of Planned Maintenance System materials; and the creation of the USMC Warfighter Portal, an Internet-based front end to the Marine Corps Combat Service Support systems.

## SUMMARY

The DON is committed to simplifying the acquisition process, streamlining the bureaucratic decision-making process, and promoting innovation through the use of electronic government, or e-government, initiatives. To achieve these objectives and the goals set forth in the QDR, the National Security Strategy, the Annual Defense Report, and the President's Management Agenda, transformation is necessary in operations as well as in business practices. All DON leaders, uniformed and civilian, are now thinking in terms of maximum productivity, minimum overhead, and measurable output. Every dollar the taxpayers entrust for the nation's defense needs must be spent wisely.

The Department of the Navy operates the most potent naval forces in the world. Despite facing the challenges of recruiting and retaining the best people, maintaining adequate force structure, recapitalizing aging infrastructure, and fighting both symmetrical and asymmetrical threats, the DON is clear of purpose, focused on the future, and confident in its capabilities. By successfully meeting the challenges outlined here, it will remain ready to assure America's allies and friends, to deter its potential adversaries, and to defeat its enemies.

## CONTROLS AND LEGAL COMPLIANCE

To ensure that the DON's mission and objectives are met, internal accounting and administrative controls are evaluated in accordance with Office of Management and Budget (OMB) and DoD guidance.

The objective of this evaluation is to provide reasonable assurance that

- obligations and costs are in compliance with applicable laws;
- funds, property, and other assets are safeguarded against waste, loss, unauthorized use, or misappropriation; and
- revenues and expenditures applicable to agency operations are properly recorded and accounted for to permit the preparation of reliable accounting, financial, and statistical reports and to maintain accountability over the assets.

The evaluation of management controls extends to every responsibility and activity undertaken by the DON and is applicable to financial, administrative, and operational controls. Evaluation of DON systems was performed in accordance with the guidelines identified above. The results indicate that the system of internal accounting and administrative control of the DON in effect during the fiscal year that ended 30 September 2002, taken as a whole, complies with the requirement to provide reasonable assurance that the above-mentioned objectives were achieved. (For additional details, refer to the FY 2002 DON Statement of Assurance.)

# Department of the Navy

## DEPARTMENT OF THE NAVY GENERAL FUND PERFORMANCE MEASUREMENT AND FINANCIAL ANALYSIS

The Department of the Navy (DON) operates in multiple countries, at sea and ashore, in every time zone and every climactic region; the spotlight never leaves our emblem. With a charter to defend the nation and its interests at home and abroad, it is essential that every DON employee take an active role in using resources wisely, ensuring success in each endeavor. Improving programs by focusing on results is an integral component of the DON's transformation initiatives.

### Budget and Performance Integration

The President stated that his Administration is "dedicated to ensuring that the resources entrusted to the federal government are well managed and wisely used." Improving programs by focusing on results is an integral component of the DON's budget and performance integration initiative. As part of this government-wide initiative, the Office of Management and Budget (OMB) has instituted Program Performance Assessments for the budget process, which identify programs that will be measured in "getting to green."

A critical goal for future budget submissions is to improve the program rating process by making ratings more consistent, objective, credible, and transparent. The report developed for use in the rating of programs is called the Program Assessment Rating Tool (PART). The PART is a series of questions designed to provide a consistent approach to rating programs across the federal government. The PART is a diagnostic tool that relies on objective data to inform evidence-based judgments and evaluate programs across a wide range of issues related to performance.

### The initial draft PARTS from OMB include:

- Air combat
- Basic research
- Combined COM infrastructure
- Housing
- Shipbuilding

In addition to the PART, the 2001 Quadrennial Defense Review (QDR) established a risk framework that will ensure the nation's military is properly prepared to carry out the strategy. Within the framework there are four tenets of risk management:

- force management;
- operational risk;
- future challenges; and
- institutional risk.

Once these risk tenets have been fully assessed, the actions taken to mitigate potential vulnerabilities will further enhance DON's ability to balance defense strategy, force structure, and resources.

Additional performance information may be obtained from DON's FY 2004 and FY 2005 Budget Submissions and from the Department of Defense's Annual Performance Report

### PERFORMANCE MEASUREMENT

The DON is continuing to use the performance metrics established in the FY 2001 QDR; it is recognized that some metrics may change once guidance has been finalized. For purposes of this annual financial report, one performance measure per goal was selected to demonstrate the type of information that will be incorporated into the revised standards for performance measurement. *Information derived from the FY 2004 DON Budget Submission to the Secretary of Defense*

Annual Performance Goal	Performance Measure
Force Management	Force Levels
Operational Risk	Operational Tempo
Future Challenges	Ship Programs
Institutional Risk	Current Initiatives





## Goal 1: Force management

This goal measures the DON's ability to recruit, retain, train, and equip sufficient numbers of quality personnel and sustain the readiness of the force while accomplishing operational tasks. Trained and adequately compensated manpower is the most important resource in our readiness equation. America's naval forces are combat-ready largely due to the dedication and motivation of our sailors, marines, and civilians. The development and retention of quality people are vital to the DON's continued success and are among the Department's biggest challenges. Meeting these challenges is essential to long-term effectiveness, and the DON continues to focus on three fronts: recruiting the right people, retaining the right people, and reducing attrition.

### PERFORMANCE MEASURE

#### Force Levels

The DON met all force level goals in FY 2002 as detailed below.

Battleforce Ships	313
Naval Reserve Force Ships	15
Strategic Sealift Ships	110
Active Air Wings	18
Reserve Air Wings	5

## Goal 2: Operational risk

This goal measures the DON's ability to achieve military objectives in a near-term conflict or other contingency.

### PERFORMANCE MEASURE

#### Operational Tempo (OPTEMPO)

Deployed ship operations are budgeted to maintain highly ready forces, perform the full spectrum of military activities, and to meet forward deployed operational requirements and overseas presence commitments in support of the National Military Strategy.

For deployed forces, the DON met its goal of 54.0 underway days per quarter in FY 2002. The DON also met its goal of 28.0 underway days per quarter for non-deployed forces.

## Goal 3: Future challenges

This goal measures the DON's ability to invest in new capabilities and develop new operational concepts needed to dissuade or defeat mid to long-term military challenges.

### Ship Programs

The DON continues to address the requirement for the acquisition, modernization, and recapitalization of the world's preeminent fleet. Continuing to integrate emerging technologies, the DON will ensure that tomorrow's fleet remains on the cutting edge. This is manifested by development efforts for the CVN(X), DD(X), and Littoral Combat Ship (LCS).

- CVN(X). The DON continues to support the requirement for future carriers, specifically with the development of the CVN(X). The CVN(X) will be the future centerpiece of the battlegroup, incorporating new electrical generation, distribution, and radar systems.
- DD(X). The DD(X) is the centerpiece of the transformational 21st century family of surface combatants. DD(X) will be a multi-mission surface combatant, providing offensive, distributed, and precision firepower at long ranges in support of forces ashore.
- LCS. The Littoral Combat Ship is envisioned to be a fast, agile, stealthy, relatively small and affordable surface combatant capable of operating in support of small boat prosecution, mine counter measures, shallow water anti-submarine warfare, intelligence, surveillance, and reconnaissance.
- Submarine programs. The DON has continued to modernize its existing submarine fleet with the latest technology ensuring the viability of these critical ships, while, at the same time, continuing to replace aging fast attack submarines with the new Virginia class submarine.



# Department of the Navy

## Goal 4: Institutional risk

This goal measures the DON's ability to develop management practices and controls that use resources efficiently to promote the effective operation of the Defense establishment.

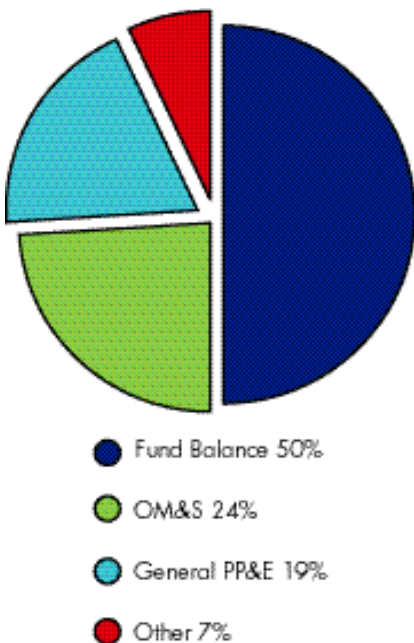
The DON continues to become more efficient, examining opportunities to improve the "way we do business." Making the process more efficient leads to more effective results and to solutions that are affordable. Towards this end, the DON is establishing metrics to monitor critical functional areas that are vital to our success.

Initiatives currently underway that are revolutionizing the way we do business include:

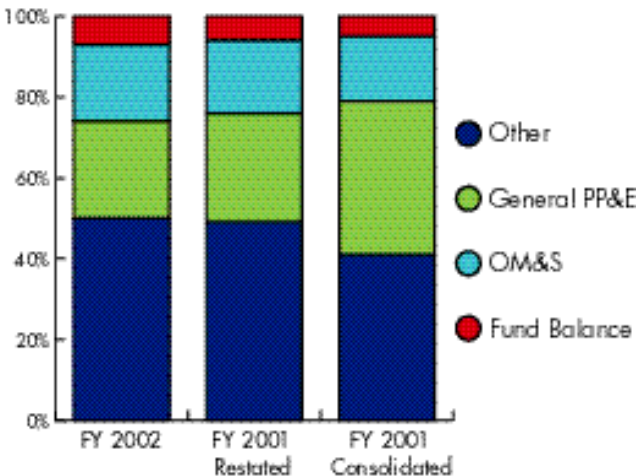
- Navy Marine Corps Intranet;
- Enterprise Resource Planning;
- Electronic Business;
- Strategic Sourcing; and
- Risk Management.

## FINANCIAL ANALYSIS

### FY 2002 Asset Composition



### FY 2002/FY 2001 Asset Comparison



Asset composition remained relatively constant between the FY 2002 and the FY 2001 Restated financial statements. Operating Material & Supplies (OM&S) was significantly higher in the FY 2001 Consolidated financial statements due to the inclusion of tactical missiles and torpedoes. Fund Balance with Treasury, which represents funds available to the DON that are on deposit with the U.S. Treasury, remained the largest component of assets.

As the Federal Accounting Standards Advisory Board (FASAB) exposure draft "Eliminating the Category National Defense Property, Plant and Equipment" is approved and implemented by the DON, shifts in asset composition are anticipated. As a whole, the DON expects to recognize significant increases in Asset values as Military Equipment, previously reported as Required Supplementary Stewardship Information, is capitalized.

#### Fund Balance with Treasury (\$ in thousands)

FY 2002	FY 2001 Restated and Consolidated	Percentage Change
\$ 68,249,955	\$ 66,338,979	- 2.88%

The Fund Balance with Treasury represents the aggregate amount of funds for which DON is authorized to make expenditures.





### Operating Materials and Supplies (OM&S), Net (\$ in thousands)

FY 2002	FY 2001 Restated	Percentage Change	FY 2001 Consolidated	Percentage Change
\$ 33,003,595	\$ 36,295,749	- 9.07%	\$ 61,061,553	- 45.95%



OM&S consists of spares and repair parts, ammunition, and munitions. The 9.07% decrease between FY 2002 and FY 2001 Restated numbers is primarily attributable to:

- A Department of Defense Inspector General (DoDIG) recommended audit adjustment to remove mobile facilities, aviation support equipment, and calibration standard material that was misclassified as OM&S in FY 2001; and
- Implementation of the Office of the Undersecretary of Defense (Comptroller) (OUSD(C)) policy as stated in "Accounting for Excess, Unserviceable and Obsolete (EOU) Inventory and Operating Materials and Supplies." DON's implementation resulted in items traditionally reported as EOU being reclassified to the categories "held for use" and "held for repair".

The 45.95% decrease between FY 2002 and FY 2001 Consolidated numbers is also impacted by a DoDIG recommendation to remove tactical missiles and torpedoes that were previously reported as ammunition and munitions in the FY 2001 Consolidated statements.

Going forward, the implementation of FASAB's exposure draft "Eliminating the Category National Defense Property, Plant and Equipment" will continue to impact OM&S values.

### General Property, Plant, and Equipment (PP&E), Net (\$ in thousands)

FY 2002	FY 2001 Restated	Percentage Change
\$ 24,109,437	\$ 24,961,487	4.60%

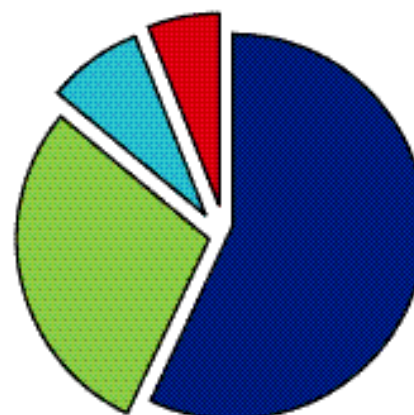
General PP&E is made up of land, buildings, structures, utilities, software, equipment, assets under capital lease, and construction-in-progress. The 4.60% increase is the result of DON's ongoing efforts to ensure total asset visibility.

### All Other Assets (\$ in thousands)

FY 2002	FY 2001 Restated and Consolidated	Percentage Change
\$ 8,530,186	\$ 8,999,152	- 5.21%

The Other category noted above consists of Accounts Receivable, Investments, Advances, Prepayments, and Other Assets. The decrease of 5.21% is primarily attributable to fewer outstanding contract financing payments.

### FY 2002 Liability Composition

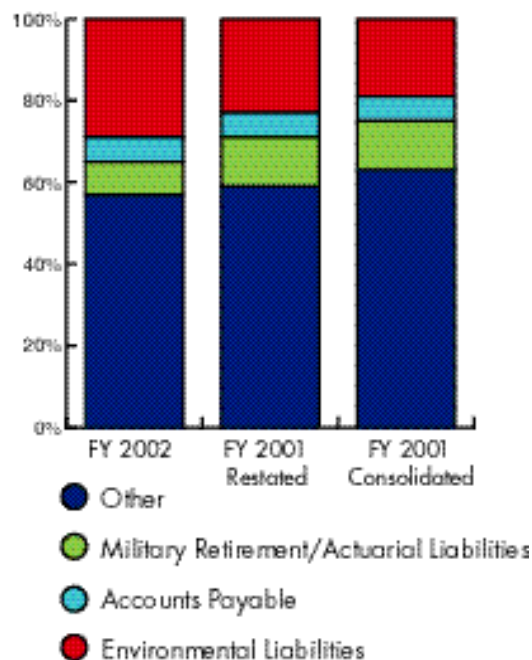


- Environmental Liabilities 57%
- Other 29%
- Accounts Payable 8%
- Military Retirement/Actuarial Liabilities 6%



# Department of the Navy

## FY 2002/FY 2001 Liability Comparison



FY 2002 liabilities increased by \$531,007 thousand when compared to the 2001 Restated totals. This principle factor in the increase is Other Liabilities. Overall, FY 2002 liabilities increased by \$2,014,372 thousand when compared to the 2001 Consolidated totals.

## Accounts Payable (\$ in thousands)

FY 2002	FY 2001 Restated and Consolidated	Percentage Change
\$ 2,258,608	\$ 3,077,308	- 26.60%

DON's active pursuit of timely vendor payments is the primary driver in the decrease of Accounts Payable. It is important to note that DON's Accounts Payable balance is directly affected by the elimination process based upon trading partner submissions. Current funding levels and the status of budget execution also affect Accounts Payable.

## Environmental Liabilities (\$ in thousands)

FY 2002	FY 2001 Restated and Consolidated	Percentage Change
\$ 15,469,073	\$ 15,584,458	- .74%

DON's Environmental Liabilities include the Defense Environmental Restoration Program (DERP) and environmental disposal for weapon systems. During FY 2002, DON completed accreditation of the Cost to Complete model for DERP reporting.

## Military Retirement Benefits and Other Employment-Related Actuarial Liabilities (\$ in thousands)

FY 2002	FY 2001 Restated and Consolidated	Percentage Change
\$ 1,546,375	\$ 1,595,890	- 3.10%

Military Retirement Benefits and other Employment-Related Actuarial Liabilities are associated with the Federal Employees Compensation Act (FECA). Data is derived from actuarial estimates provided by the Department of Labor. The liability is determined using a method that utilizes historical benefit payment patterns to predict future payments.

## All Other Liabilities (\$ in thousands)

FY 2002	FY 2001 Restated	Percentage Change	FY 2001 Consolidated	Percentage Change
\$ 7,675,117	\$ 6,160,510	24.59%	\$ 4,677,145	64.10%

Other Liabilities consists of Debt and Other Liabilities. FY 2001 Consolidated and Restated totals differ by \$1,483,365 thousand. The difference is attributed to the A-12 aircraft program Accounts Receivable balance. In FY 2002, the DON recorded an adjustment to reflect the fact that any collections would be surrendered to Treasury.



## ORGANIZATION OF THE NAVY WORKING CAPITAL FUND

The Navy Working Capital Fund (NWCF) is comprised of five primary business areas, each of which has a unique contribution to make in support of the DON mission. The five business areas are as follows:



Each business area is further supported by one or more primary Activity Groups, which have distinct but complementary missions. Details of the mission, structure, and performance of the Activity Groups and their associated activities are provided in subsequent sections of this report.

The Activity Groups of the NWCF do not receive an annual appropriation, but receive their cost authority from customer orders. NWCF activities accept these orders, perform work and/or deliver goods to their customers, and bill the customers. The costs are initially incurred against the NWCF and the payments from customers reimburse the respective NWCF activity. Pricing of the goods and services is based primarily on stabilized rates. This cycle is continuous, and the NWCF is thus considered a revolving fund.

This report also contains supporting Consolidating/Combining Statements representing the financial position and results of operations for the NWCF reporting segments. The reporting segments include the Navy Component Level, Ordnance, and the Information Services statements. The financial information for these reporting segments reflects administrative rather than functional performance:

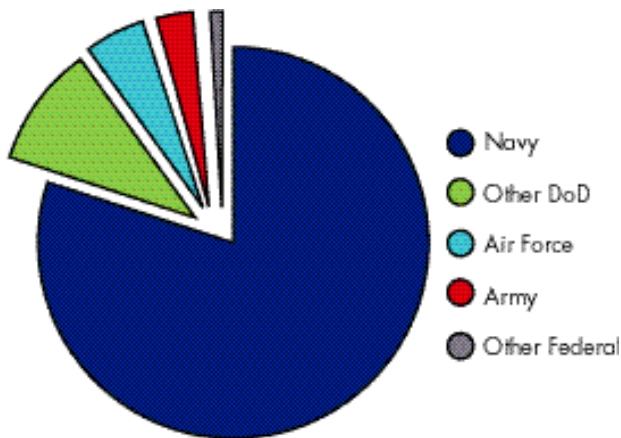
- The Navy Component Level reporting segment is a nonoperational administrative segment for the purpose of capturing and reporting department-level transactions and adjustments.
- The Ordnance business area transferred to the General Fund in FY 2000. The balances for this group reflected in the FY 2002 Annual Financial Statements represent residual accounting transactions. Residual accounting is necessary to ensure that the requirements initiated by the NWCF are ultimately funded by the NWCF.
- The Information Services business area was dissolved at the end of FY 2001. The operations of both the Fleet Material Support Office (now called the Naval Systems Information Systems Activity) and the Space and Naval Warfare Systems Command, Information Technology Center that comprised this business area were effectively merged beginning FY 2002 to the Supply Management-Navy business area and SPAWAR's General Fund. All residual NWCF transactions were transferred to SSC Charleston, respectively. The related financial activity in the Consolidating/Combining Statements reflects residual accounting events.
- The statements and related notes are presented on a comparative basis with information previously reported for the fiscal year ending September 30, 2001. In accordance with SSFAS No. 21, the FY 2001 presentation has been restated to show the correction of a material error discovered in FY 2002, and is identified in the Financial Statement presentation in the column titled "Restated 2001". More information about this prior period adjustment may be found in Note 20.



# Department of the Navy

## THE CUSTOMERS OF THE NWCF

The Required Supplementary Information section of this report details the revenue earned by the NWCF from transactions with customers throughout the federal government. Analysis of these transactions indicates that the Department of the Navy General Fund provided the NWCF with the largest dollar amount of work in FY 2002, accounting for \$17.7 billion of the total \$20.9 billion earned. The chart below depicts the customers of the NWCF:



**NWCF Intragovernmental Revenue Earned, by Customer (\$ in thousand)**

Navy General Fund	\$ 17,766,429	85.0%
Other DoD	2,110,079	10.1%
Air Force	509,142	2.4%
Army	215,160	1.0%
Other Federal	315,450	1.5%
<b>Total</b>	<b>\$ 20,916,260</b>	<b>100.0%</b>

The NWCF will continue to be a major support element for the operating forces of the Navy and Marine Corps with total cost of goods and services to be sold by the NWCF projected to exceed \$22 billion in FY 2003<sup>1</sup> and \$23 billion in FY 2004<sup>2</sup>.

<sup>1</sup> FY 2003 Highlights of the Department of the Navy Budget Submission to the Secretary of the Defense, February 2002.

<sup>2</sup> FY 2004 Highlights of the Department of the Navy Budget Submission to the Secretary of the Defense, August 2002.

## PERFORMANCE MEASURES

### The Net Cost of Operations

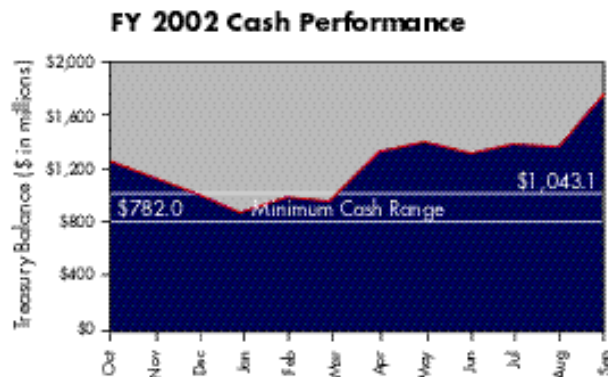
The NWCF activities operate under the principle of controlling costs or expenses that are then offset by revenue, as opposed to a metric based on obligating funds before they expire. Analysis of Earned Revenue, Program Cost, and the Net Cost of Operations can thus provide an indication of how well the NWCF is performing as it seeks to break even over the long-term.

For nonsupply activities, the revenue earned in the NWCF is based primarily on stabilized rates that are calculated to cover the estimated costs of products and services provided by the NWCF. These rates also take into account any prior-year gains or losses. Within the Supply Management Activity Group, revenue is earned based on a cost recovery factor assigned to inventory units.

Under the Working Capital Fund concept, all cost elements are visible, including direct costs, indirect costs (overhead), and general and administrative costs. These cost elements are tied to a measurable, identifiable output.

### Cash Management

For the NWCF, cash management is maintained at the DON level. The requirement for the NWCF is to maintain seven to 10 days of operating cash and six months of capital outlays. For FY 2002, the seven-day cash requirement was \$782.6 million, and the 10-day cash requirement was \$1,043.1 million.



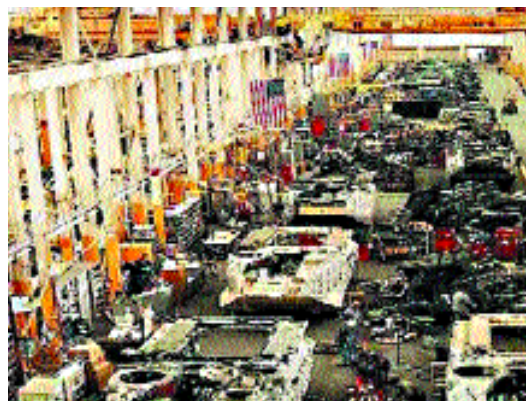


The NWCF Treasury cash balance as of September 30, 2002 was \$1,709.7 million, compared to the President's budget projection of \$1,051.3 million. The Treasury cash balance exceeded budget projections primarily because of the additional workload and accompanying sales and revenue associated with Operation Enduring Freedom.

## MISSION, OPERATING RESULTS, AND PERFORMANCE BY BUSINESS AREA

### Depot Maintenance

The mission of Depot Maintenance, in general, is to provide responsive worldwide maintenance, engineering, and logistics support to operational forces and to maintain the essential industrial capability to support mobilization. Because of the nature and diversity of the equipment within the DON, three activity groups specializing in ships, aviation, and the Marine Corps, respectively, carry out the mission. The type of support provided by the depot maintenance activities can include design, construction, overhaul, and repair on anything from ship parts and aircraft engines to ground equipment.



### Depot Maintenance Net Cost of Operations (\$ in thousands)

	FY 2002	Revised FY 2001	FY 2001
Earned Revenue	\$ 4,787,303	\$ 3,120,900	\$ 3,120,900
Program Costs	\$ 5,234,807	\$ 3,961,188	\$ 3,961,888
Net Cost of Operations	\$ (447,504)	\$ (840,988)	\$ (840,988)

### Transportation

One NWCF Activity – the Military Sealift Command (MSC) – comprises the transportation business area.

The mission of the MSC is to provide ocean transportation of equipment, fuel, supplies and ammunition to sustain U.S. forces worldwide during peacetime and in war.

The MSC has dual reporting responsibilities to the DON and to the United States Transportation Command (USTRANSCOM). As a working capital fund, MSC supports three separate and distinct ship programs:

- The Naval Fleet Auxiliary Force (NFAF) provides support using civilian mariner manned noncombatant ships for material support;
- Special Mission Ships (SMS) provides unique seagoing platforms; and,
- Afloat Pre-positioning Ships – Navy (APF-N) provides deployment of advance material for strategic lifts.



During a war, more than 95 percent of all the equipment and supplies needed to sustain the U.S. military are carried by sea.

— MSC Mission and Vision



# Department of the Navy



MSC ships are unique as compared to other US Navy ships in that:

- they are non-combatant;
- they include both government-owned and chartered vessels; and
- they are crewed primarily by civilian mariners from the US Civil Service and from private operating companies.

## Transportation Net Cost of Operations (\$ in thousands)

	FY 2002	Restated FY 2001	FY 2001
Earned Revenue	\$1,518,664	\$1,337,799	\$1,337,799
Program Costs	1,387,148	1,696,422	1,696,422
Net Cost of Operations	\$ 131,516	\$(358,623)	\$(358,623)

## Performance Indicators

As one of the primary logistical support mechanisms during war, it is critical that the MSC meet its availability goals to support a Naval force that is armed and ready to react. MSC has a history of maintaining a more than 96% readiness in all vessel categories in the past three years. This measurement is based in "goal days", which is the number of days for a ship to be available multiplied by the number of ships in the program. The availability measures the days the ships are actually available to perform the mission to which they are assigned against the planned number of available days.

	Goal (days)	Actual (days)	Actual Days to Goal Days (%)
<b>Naval Fleet Auxiliary Force</b>			
FY 2002	24,091	24,212	100.5%
FY 2001	22,020	22,017	100.0%
FY 2000	21,594	21,329	98.8%
<b>Afloat Pre-positioning - Navy</b>			
FY 2002	6,020	6,020	100.0%
FY 2001	5,842	5,689	97.4%
FY 2000	5,673	5,605	98.8%
<b>Special Mission Ships</b>			
FY 2002	10,128	10,142	100.1%
FY 2001	9,942	9,630	96.9%
FY 2000	9,785	9,445	96.5%

## Base Support

The Base Support business area provides the support to maintain the land-based installations for our globally deployed Navy and Marine Corps through two primary activities: Naval Facilities Engineering Service Center (NFESC) and Public Works Centers (PWC).

The NFESC provides engineering, design, construction, technology implementation, and management support worldwide to shore, ocean, and waterfront activities and to amphibious and expeditionary operations. Responsibilities range from providing shore establishment physical security to environmental waste management to energy conservation systems.



The mission of the PWCs is to provide the public works support and services to meet the diverse needs of their clients. The Navy PWCs provide utilities services, facilities maintenance, family housing services, transportation support, engineering services, and shore facilities planning support to afloat and ashore operating forces and other activities. In addition to providing base support to the Navy and Marine Corps, the PWC's also provide support to other federal and nonfederal entities including the Coast Guard and the National Aeronautics and Space Administration.



### Base Support Net Cost of Operations (\$ in thousands)

	FY 2002	Restated FY 2001	FY 2001
Earned Revenue	\$ 1,691,934	\$ 1,482,617	\$ 1,482,617
Program Costs	1,654,492	1,663,708	1,663,708
Net Cost of Operations	\$ 37,442	\$ (181,091)	\$ (181,091)

### Performance Indicators

As new programs are added to the NFESC workload and the automation of manual processes continues, the number of indirect workyears required to support direct workyears has continued to decline reflecting an overall increase in productivity.

Productivity Ratio:  
FY 2002 74.1%  
FY 2001 71.7%  
FY 2000 67.5%

## Research & Development

Robust experimentation involving operational concepts, systems, platforms, organizations, and tactics is essential to transforming and leveraging our current forces while speeding the integration of new capabilities and new technologies. We are not waiting for the future. We are transforming how we fight today.

— Report of the Secretary of the Navy  
Annual Defense Report given to the  
Congress for FY 2002 by the  
Secretary of Defense

The Research & Development Activity Group explores the application of twenty-first century technology for the United States Naval forces dedicated to projecting U.S. power and influence from the sea, to shaping events ashore, and to maintaining the freedom of the seas. The NWCF Research & Development Activity Group is supported by the Naval Warfare Centers and the Naval Research Laboratory.

The Naval Warfare Centers operate the Navy's full spectrum of research, development, test and evaluation, engineering and fleet support to the surface, undersea, and air combat forces, as well as the DON's command, control and communication network. Following is a brief description of each of the warfare centers leadership areas that effectively optimizes overall coverage and support.



# Department of the Navy

**Naval Surface Warfare Center (NSWC)** – The NSWC specializes in ship hull, mechanical, and electrical systems, surface ship combat systems, coastal warfare systems, and other offensive and defensive systems associated with surface warfare.

**Naval Undersea Warfare Center (NUWC)** – The NUWC specializes in submarines, autonomous underwater systems, and offensive and defensive weapons systems associated with undersea warfare.

**Naval Air Warfare Center (NAWC)** – The NAWC specializes in engines, avionics, and aircraft support systems, ship/shore/air operations, weapons systems associated with air warfare, missiles, and missile subsystems, aircraft weapons integration, and airborne electronics warfare systems. The center also operates the department’s air, land, and sea test ranges.

**Space and Naval Warfare Systems Centers (SSCs)** – The SSCs specialize in command, control, and communication systems and ocean surveillance, and the integration of those systems that overarch multiple platforms.

The **Naval Research Laboratory (NRL)** is the DON’s principal R&D activity. It operates as a full-spectrum corporate laboratory, conducting a broadly based multidisciplinary program of scientific research and advanced technological development. Research and development is principally directed toward maritime applications of new and improved materials, techniques, equipment, systems and ocean, atmospheric, and space sciences and related technologies.



## Research & Developemnt Net Cost of Operations (\$ in thousands)

	FY 2002	Restated FY 2001	FY 2001
Earned Revenue	\$ 9,470,297	\$ 7,731,223	\$ 7,731,223
Program Costs	9,158,581	9,193,314	9,193,314
Net Cost of Operations	\$ 311,716	\$ (1,462,091)	\$ (1,462,091)

## Supply Management

The Supply Management business area is distinctly different from the other NWCF business areas previously discussed. Instead of recovering costs through stabilized rates, the Supply Management business area recovers its cost through a “cost recovery rate”. The cost recovery rate encompasses different elements of operating costs that are then added to the acquisition cost of an item to establish a standard selling price. The two activities that comprise the Supply Management business area are Supply Management-Navy and Supply Management-Marine Corps.





The Navy and Marine Corps Supply Management activities provide a means of managing, controlling, financing and accounting for the acquisition and sale of secondary spares, consumable and repair parts necessary to support weapon systems and associated equipment to a wide variety of DON activities and other government agencies.

### Supply Management Net Cost of Operations (\$ in thousands)

	FY 2002	Restated FY 2001	FY 2001
Earned Revenue	\$ 6,463,455	\$ 5,275,532	\$ 5,275,532
Program Costs	7,167,805	3,950,507	3,950,488
Net Cost of Operations	\$ (704,350)	\$ 1,325,025	\$ 1,325,044

The Naval Supply Information Systems Activity, formally the Navy Fleet Material Support Office within the Information Services business area, was transferred beginning in FY 2002 to the Supply Management – Navy activity. The FY 2001 Earned Revenue, Program Cost and Net Cost of Operations have been adjusted to reflect this organizational change for comparative purposes.

